
Regional Outlook

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In Focus This Quarter

◆ *Recent Trends Raise Concerns about the Future of Business Credit Quality*—Commercial and industrial (C&I) lending is one of the largest and fastest-growing lending lines at insured institutions. Recent growth in C&I lending can be attributed to a strong U.S. economy, increased industrial merger activity, and a willingness of lenders to extend credit. While C&I credit quality remains relatively strong, signs of deterioration have recently begun appearing in C&I portfolios and in corporate bond defaults. These signs of weakness in commercial credit quality raise concerns because they are appearing during a period of economic strength. Business credit quality could deteriorate further in the event of an economic slowdown, higher interest rates, or a loosening of underwriting practices. *See page 3.*

By Arlinda Sothoron, Alan Deaton

◆ *Local Industries in the Global Economy*—The contribution of international trade to overall U.S. economic activity has been increasing for a number of years. Although the United States trades with many nations, most activity is concentrated in a few markets—Canada, Japan, and Mexico. Across a collection of industries, there is, however, considerable variation in both the level of exposure to export markets and the intensity of import competition. A number of industries are highly exposed to international markets, suggesting that economic conditions abroad are particularly important in any assessment of future revenue growth or profitability. *See page 11.*

By Paul C. Bishop

Regional Perspectives

◆ *Region's Economic and Banking Conditions*—The Boston Region's economy continued to expand during 1999 but showed signs of slowing. Insured institutions reported healthy financial conditions. Despite falling margins for most institutions over the past two years, profitability levels remained fairly stable. *See page 18.*

◆ *Region's Insured Institutions Exhibit Lower Risk Profile than the Nation's*—Commercial lending activity has been brisk in the Boston Region for several years. Rapid commercial loan growth has been partially offset, however, by slow growth or even declines in other higher-risk sectors of the loan portfolio. Loan loss reserves, although slowly declining over the past few years, have remained well above national averages. Overall, the risk profile of the Region's insured institutions shows no material adverse trends. *See page 20.*

By the Boston Region Staff

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Recent Trends Raise Concerns about the Future of Business Credit Quality

- C&I loan portfolios have been growing rapidly during this economic expansion.
- Indicators of weakening corporate credit quality have begun to appear, including higher C&I loan losses and rising corporate bond defaults.
- The future of business credit quality will depend on the economy and on underwriting practices.

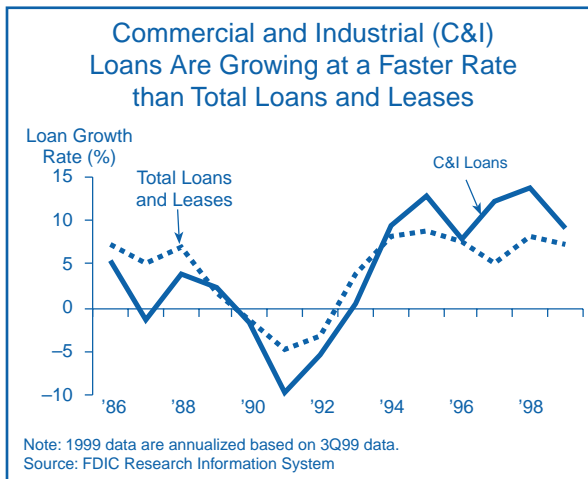
Commercial and industrial (C&I) lending is one of the largest and fastest-growing segments of lending at insured institutions. As of the third quarter of 1999, C&I loans comprised 24 percent of total loans and leases held by FDIC-insured institutions, up from 21 percent at the end of 1995. C&I loan portfolios have grown primarily because of strong loan demand driven by a long economic expansion during which the indebtedness on corporate balance sheets has expanded rapidly. Even as the economic expansion continues, C&I loan charge-offs have begun to trend upward, albeit from historically low levels. By some measures, banks and the financial markets appear to be assuming increased levels of risk that could lead to greater C&I loan losses when the economy eventually weakens.

High rates of growth in commercial lending and weakening indicators of C&I credit quality raise concerns about the future of credit quality at insured institutions. This article examines the factors that have contributed to high C&I loan growth rates and discusses the drivers that will determine the direction of C&I credit quality in the future. While loan performance at insured institutions is relatively good at the present time, signs of deterioration and stress have begun to appear despite the continued strength of the domestic economy. The future of C&I credit quality will ultimately be determined by trends in underwriting and corporate debt levels, along with the performance of the U.S. economy.

C&I Loan Growth Has Accelerated

C&I loans held by FDIC-insured banks and thrifts grew by almost 9 percent during the 12 months ending in September 1999, down somewhat from a 13.4 percent rate of growth in 1998 (see Chart 1). By contrast, total

CHART 1



loans and leases at insured institutions grew by only 7 percent in the 12 months ending in September 1999. C&I loans accounted for approximately 29 percent of all net new loans booked during the 12 months ending in September 1999, while unfunded C&I loan commitments grew by approximately 17 percent to \$1.6 trillion. Syndicated lending played a major role in C&I loan growth during the 1990s. As intense competition and a narrowing of financial institutions' net interest margins have encouraged lenders to seek additional sources of revenue, larger institutions have become increasingly active as loan syndicators and as purchasers of syndicated credits. Syndicated loan volume reached its peak in 1997, when originations totaled some \$1.1 trillion (see Chart 2, next page).¹ After falling off in 1998, originations of syndicated loans rose by 17 percent in 1999 to just over \$1.0 trillion. Leveraged loans, in which the borrower's debt-to-equity ratio is significantly higher than the industry average, served as a catalyst for syndicated lending growth in 1999, accounting for 32 percent of total syndicated loan originations. Leveraged lending is very attractive to lending institutions because of the generous fee income associated with leveraged originations. Leveraged loan originations grew to \$320 billion in 1999, partly because of the continued rapid pace of corporate mergers in 1999.²

¹ *LPC Gold Sheets*, Vol. XIV, No. 1. Loan Pricing Corporation. January 10, 2000.

² According to Houlihan Lokey's *Mergerstat*, total M&A activity set a new record of \$1.4 trillion in merger deal value in 1999.

Most of the C&I loan growth among insured institutions since 1997 has been concentrated in loans to domestic borrowers. C&I loans held in foreign offices declined following the Asian economic crisis and the Russian government bond default in 1997 and 1998, respectively, while domestic C&I lending was growing at double-digit rates. During the 12 months ending in September 1999, C&I loans held in domestic offices grew 12.2 percent while C&I loans held in foreign offices declined by almost 6 percent.

Is This Rapid Loan Growth a Cause for Concern?

The effect of rapid loan growth on subsequent credit quality has been the subject of a number of articles. A recent study by the **Federal Reserve Bank of Kansas City** found that high rates of loan growth in the early 1980s and early 1990s appeared to be positively correlated with future higher loss rates.³ The study also noted, however, that relatively high loan growth rates in the late 1980s did not result in sharply higher loss rates. Another study by the **Federal Deposit Insurance Corporation** found that banks that failed during the banking crisis of the 1980s were generally more likely to have grown their loan portfolios aggressively than banks that did not fail.⁴ But it remains to be seen whether the high C&I loan growth rates of today will necessarily contribute to higher losses for insured institutions in the future. The future course of industry loan losses depends on many factors, including the condition of the economy, the interest rate environment, and underwriting standards used in originating C&I credits.

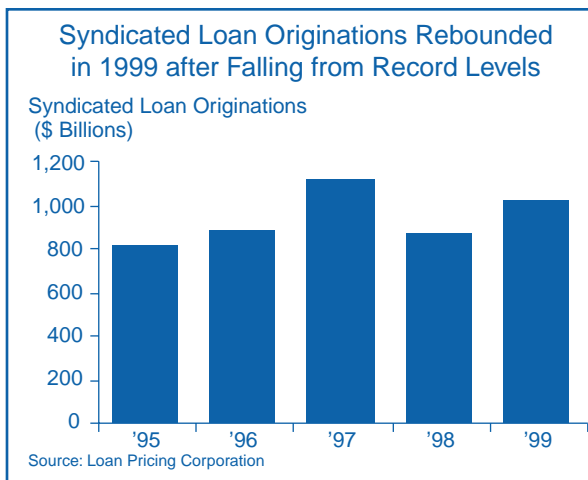
The Condition of the Economy Is an Important Driver of C&I Loan Growth

Recent economic conditions have been particularly conducive to rapid growth in domestic C&I lending. Business investment has expanded at double-digit annual rates as firms have invested in new technologies to raise productivity and keep costs down. These productivity gains have been instrumental in allowing the

³ William R. Keeton. "Does Faster Loan Growth Lead to Higher Loan Losses?" *Economic Review*. Federal Reserve Bank of Kansas City. Second quarter 1999.

⁴ Federal Deposit Insurance Corporation, Division of Research and Statistics. *History of the Eighties: Lessons for the Future. Vol. 1, An Examination of the Banking Crises of the 1980s and Early 1990s*. 1997. <http://www.fdic.gov/bank/historical/history/contents.html>.

CHART 2



economy to grow at a relatively rapid pace with low inflation. Strong growth in real wages has helped boost the consumer confidence index to an all-time high of 144 in January 2000. Robust consumer demand for goods and services has kept business profits growing, further spurring business borrowing to finance inventories, new construction, and fixed assets such as computer networks. Amid all of these favorable trends, C&I loan charge-off rates have remained at record lows of less than 0.5 percent since 1994. Recently, however, despite a continuation of generally favorable conditions in the economy and the financial markets, signs of credit quality deterioration have begun to appear in C&I loan portfolios.

Evidence from Financial Institutions Points to a Weakening in Business Credit Quality

Despite strong business conditions and generally good asset quality, signs of deterioration in C&I credit quality have begun to appear in bank portfolios. While problem C&I loan levels remain low by historical standards, net C&I loan charge-offs during the 12 months ending in September 1999 were 63 percent higher than during the previous 12-month period. The net C&I loan charge-off rate rose in the 12 months ending in September 1999 to 0.5 percent, up from 0.3 percent one year earlier. Similarly, noncurrent C&I loans as of September 1999 rose to \$11.2 billion, or 1.2 percent of total C&I loans.⁵ In dollar terms, this level of noncurrent loans is 30 percent higher than one year earlier.

⁵ Noncurrent C&I loans include C&I loans past-due over 90 days and all C&I loans in nonaccrual status.

Despite these increases in C&I charge-offs and noncurrent C&I loans, the current industry ratios for these measures remain well below the 1.9 percent and 4.5 percent ratios reported during the recession in 1991 for net C&I charge-offs and noncurrent C&I loans, respectively.

Interagency Loan Review Reveals Increases in Problem Credits from Previously Low Levels

The results of the **1999 Shared National Credit (SNC)** review provide another indication of slipping credit quality at large commercial banks.⁶ According to the **Federal Reserve Board of Governors**, adversely classified syndicated loans rose to \$37.4 billion in the 1999 review, a level approximately 70 percent higher than that reported in 1998. This figure represents 2 percent of the \$1.8 trillion in drawn and undrawn loan commitments reviewed in 1999. By contrast, adversely classified assets identified in the 1998 SNC review totaled only \$22 billion, or 1.3 percent of loans reviewed in 1998.⁷

While the level of adversely classified syndicated loans remains low, 14 percent of the loans adversely classified during the 1999 review were loans made to new borrowers since the 1998 SNC review. In reference to this finding, **Office of the Comptroller of the Currency (OCC)** First Senior Deputy Comptroller and Chief Counsel Julie Williams has noted that “Banks are booking new loans that are weak at their inception.”⁸ The high rate of adversely classified new loans could be attributable to the continued effects of loan originations made toward the end of a period of loosened underwriting standards in 1997 and early 1998. Alternatively, it could indicate a higher-risk credit mix in current C&I loan portfolios.

Signs of corporate stress that may weaken credit quality at insured institutions are also reflected in recent **Banc of America Securities** analysis of publicly available bank loan amendments.⁹ This study shows a significant increase in the number of loan amendments

generated because of covenant relief requests, from 22 percent of all loan amendments during the last six months of 1998 to 45 percent during the first ten months of 1999.

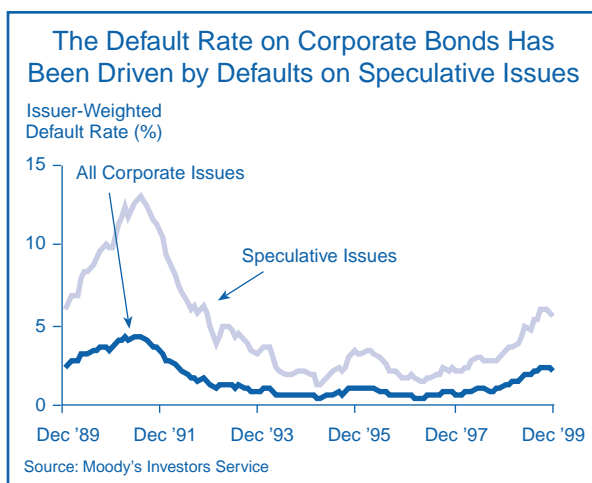
Corporate Bond Defaults Soared in 1999

Trends in corporate bond defaults also indicate increasing levels of stress in the corporate sector. During 1999, 147 issuers defaulted on \$44.6 billion in long-term debt. Default rates as a percentage of volumes outstanding (or dollar default rates) have trended upward each year since 1996, reaching 2.2 percent for all corporate issues at year-end 1999. Much of the increase can be attributed to a rising dollar default rate for speculative-grade issues, which peaked in November 1999 at 8.2 percent. Measured as a percentage of all issuers, the default rate for speculative-grade issues rose to a post-1991 high of 6 percent in September 1999 (see Chart 3). According to **Moody's**, year-end 1999 default rates improved marginally but are expected to remain high through mid-2000.¹⁰ In addition, domestic speculative-grade issuers reported twice as many issuer downgrades as upgrades during the fourth quarter of 1999, although the dollar volume of upgrades exceeded the dollar volume of downgrades by 55 percent.¹¹

¹⁰ “Corporate Bond Default Rates Highest Since 1991.” Moody’s Investors Service. October 13, 1999.

¹¹ “Moody’s Default Rate Pendulum.” Moody’s October 1999 Commentary. Moody’s Investors Service. October 18, 1999.

CHART 3



⁶ The annual interagency process reviews commercial loans over \$20 million that are shared by three or more participants.

⁷ Federal Reserve Board Press Release. November 10, 1999.

⁸ “OCC’s Williams Warns of Credit Risk in the Banking System; Calls for Bankers to Scrutinize Loan Portfolios More Closely.” OCC Press Release. October 5, 1999.

⁹ “Leveraged Loans: The Plot Thickens.” Banc of America Securities Syndicated Finance Research. November 15, 1999. This loan amendment analysis was completed using only publicly available information from Loan Pricing Corporation and Banc of America Securities LLC.

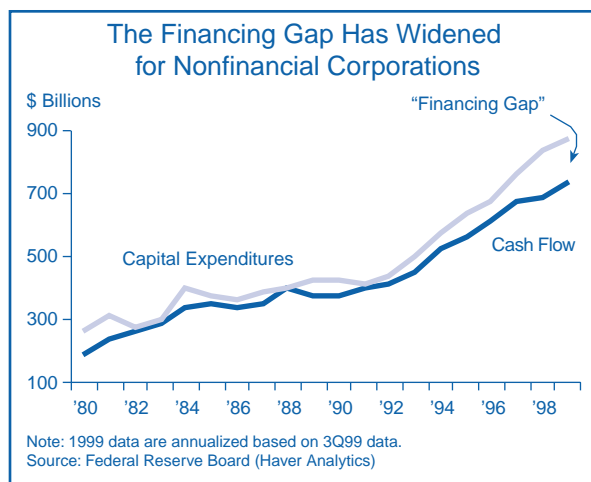
Why Are C&I Loan Losses Increasing Amid Strong Economic Growth?

Several factors have contributed to the current signs of deterioration of C&I credit quality in an environment of favorable business conditions. These factors include global competition and deflationary pressures, an increase in corporate debt levels, loosened underwriting standards, and a greater appetite for risk.

Global competition and deflationary pressures have squeezed revenues. An era of low inflation and intense global price competition has contributed to low or negative revenue growth in a number of domestic industry sectors, particularly commodities and manufacturing.¹² The result has been an increase in loan losses and corporate bond defaults in these sectors. **Moody's** noted that the industrial sector, weakened by low commodity prices, accounted for 64 percent of all defaults in 1999, with the oil and gas, steel, and shipping industries being especially hard-hit.¹³ For example, **Standard & Poor's (S&P)** reports that third-quarter 1999 earnings for the iron and steel sector declined 80 percent from one year earlier after five consecutive quarters of negative year-over-year earnings growth. Initially, commodity price declines and the international economic turmoil in 1997 and 1998 resulted in slowed foreign C&I lending and increased net losses of C&I loans held in foreign offices. These losses accounted for the majority of net C&I loan losses in 1997 and 1998. However, this adverse trend reversed itself in 1999, when C&I loans held in domestic offices accounted for the majority of losses.

Corporations are increasingly reliant on debt markets. Increasing levels of debt on corporate balance sheets have helped to foster C&I loan growth. The growth in corporate debt is partially a result of actions taken by firms to improve operating efficiency, including increasing merger and acquisition (M&A) activity and rising spending on fixed investments. Capital expenditures on fixed investments by businesses have increased at a steady rate since the 1990–91 recession, as evidenced by Chart 4. Cash flow has also been increasing, but at a slower rate, resulting in a growing “financing gap” that reached an annualized level of

CHART 4



\$142 billion in the third quarter of 1999. Where cash flow has not been available to finance investment, firms have turned primarily to debt financing as opposed to equity financing. Net new corporate equity issues by nonfarm nonfinancial corporations have been negative in each year since 1993, while net new corporate bond issuance has increased from \$75 billion in 1993 to \$219 billion in 1998.

Loosened underwriting standards in 1997 and early 1998 are contributing to current losses. Signs of stress in C&I loan portfolios can be partially attributed to loosened underwriting standards in 1997 and early 1998. During 1997 and early 1998, loan underwriting standards loosened, accompanied by reduced spreads and pricing. In May 1998, the **Federal Reserve Board Senior Loan Officer Opinion Survey on Bank Lending Practices** reported that domestic banks were “generally eager to make loans to businesses” and that during early 1998 “a large percentage cut their spreads on such loans.” **Moody's** describes the second half of the 1990s as a “mini credit cycle.” The cycle began in 1995, when the strong economy, accompanied by falling interest rates and low loan losses and default rates, encouraged investor demand for high-yield bonds and loans.¹⁴

A record number of first-time speculative-grade deals were also brought to market during 1997 and early 1998. The increase in the volume of issuance was itself enough to push the default rate lower, which in turn may have fueled investor demand for additional high-risk bonds. However, the Asian crisis during 1997 and the Russian debt default during the second half of 1998

¹² See also Richard A. Brown and Alan Deaton. “Falling Prices in Commodities and Manufacturing Pose Continuing Risks to Credit Quality.” *Regional Outlook*, third quarter 1999. <http://www.fdic.gov/bank/analytical/regional/ro19993q/na/t3q1999.pdf>.

¹³ “Historical Default Rates of Corporate Bond Issuers, 1920–1999.” Moody's Investors Service, January 2000.

¹⁴ “Default Rate Pendulum.” October 18, 1999.

caused new issuance of speculative-grade bonds to slow significantly while defaults rose sharply, to a rate of 6 percent by issuer in September 1999. While speculative-grade bond issuance declined, banks stepped in to fill the void by raising originations of highly leveraged loans between second-quarter 1998 and fourth-quarter 1999.¹⁵

Financial markets have evidenced greater risk appetite. While the ratio of speculative-grade bond issues to total corporate bond issues has remained fairly stable at approximately 40 percent during the past decade, the composition of borrowings has shifted substantially. *Moody's* reports a shift in the distribution of bond issue ratings within the speculative-grade category toward the lower end of the ratings scale (see Chart 5).¹⁶ Evidence of this shift is demonstrated by the fact that bonds rated B3 or lower currently comprise approximately 35 percent of all speculative-grade issues, a record high and up from 24 percent in 1995.¹⁷ Furthermore, almost 50 percent of the issuers that defaulted during the year ending September 1999 were rated for three years or less.¹⁸ This change in the composition of ratings has contributed to the current increase in speculative-grade defaults and could affect the future volatility and liquidity of the market. The current high volume of corporate bond defaults reflects the looser standards in 1997 and 1998 for corporate debt issued by low-rated first-time issuers, who accounted for 40 percent of rated

bond defaults in 1999.¹⁹ This relationship is analogous to the current increase in net C&I charge-offs partially attributable to weakened underwriting standards in 1997 and early 1998.

The Increase in Leveraged Lending Could Result in a Riskier Mix in C&I Loan Portfolios

Leveraged lending comprises an important part of the syndicated lending market and generates considerable fee income for financial institutions. Leveraged loans have grown from 12 percent of total syndicated loan originations in 1995 to 32 percent in 1999 (see Chart 6, next page). Leveraged syndicated loan originations grew 19 percent to \$320 billion in 1999, as investors were seeking higher risk-adjusted returns and lenders were seeking higher fees. *Paine Webber* analysts estimate that leveraged lending accounts for over 80 percent of syndicated loan fees and profits earned by loan underwriters.²⁰ Highly leveraged lending increased to a new record of \$190 billion in 1999.²¹ This growth in loan originations reflects the current high corporate demand for loans, and by definition these loans are being made to borrowers with higher-than-normal levels of financial leverage and risk. In return for their higher risk profile, leveraged borrowers must compensate financial institutions through higher pricing and higher fees.

¹⁵ *LPC Gold Sheets*. January 10, 2000.

¹⁶ *Moody's January 2000 Commentary*. January 18, 2000.

¹⁷ "Refunding Risk for Speculative Grade Borrowers." *Moody's Special Comment*. *Moody's Investors Service*. December 15, 1999.

¹⁸ "Default Rate Pendulum." October 18, 1999.

¹⁹ *Moody's January 2000 Commentary*. January 18, 2000.

²⁰ "The Biggest Secret of Wall Street." *Paine Webber Equity Research*. May 14, 1999.

²¹ *Loan Pricing Corporation* defines highly leveraged loans as those for which pricing exceeds 250 basis points over LIBOR and generally involves sub-investment-grade credits.

CHART 5

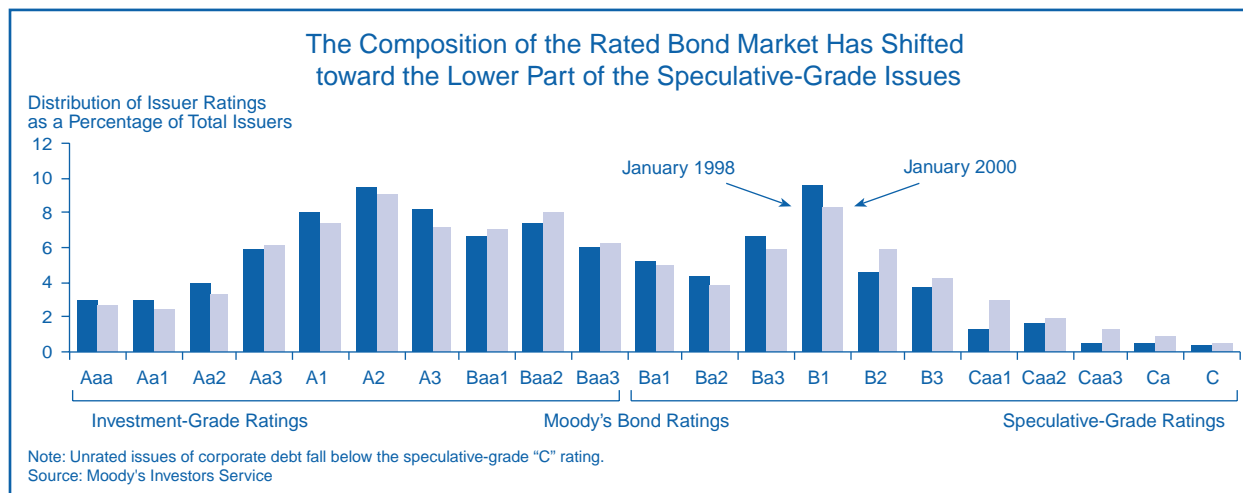
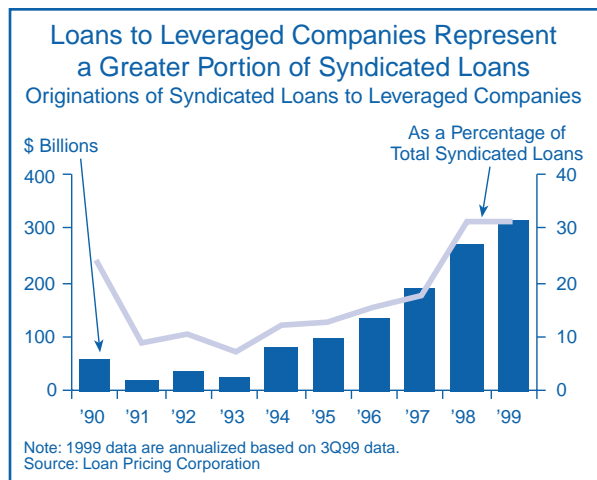


CHART 6



Leveraged lending volumes have recently been partially driven by M&A lending, which comprised over 30 percent of the total syndicated loan market in 1999. M&A activity approached \$1.4 trillion in total volume during 1999, increasing the demand for capital and driving corporations to the loan market.²² Approximately 22 percent of leveraged loans originated in 1998 were to the media and telecommunications industries, which have experienced significant levels of M&A activity.²³ Leveraged buyout activity contributed an additional 15 percent to leveraged lending volumes, surpassing 1998 levels in quantity.

Where Is Business Credit Quality Heading?

The future direction of business credit quality will be influenced by several factors, including the condition of the economy, growth in the indebtedness of corporate borrowers, exposure to vulnerable industry sectors, the interest rate environment, the development of emerging markets, and underwriting standards.

Economic growth will remain an important determinant of credit quality. Should economic growth slow and corporate profits decline, the demand for C&I loans is likely to fall, and problem asset levels are likely to rise. A recent S&P survey of global credit conditions noted that excessive credit, attributable to unsustainable corporate indebtedness and falling asset values, has weakened the financial systems of 20 nations. As for credit expansion in the United States, the survey noted

that the ratio of private sector loans outstanding to gross domestic product rose from 101 percent in 1995 to 142 percent in 1999. S&P also noted evidence that banks' C&I loan portfolios may be relying too heavily on loan repayments based on projections that are realizable only if the current economic expansion continues. S&P estimates that 5 to 15 percent of bank loans could default should the United States experience a significant downturn in the stock market leading to a hard landing for the domestic economy.²⁴

Continued growth in corporate indebtedness could contribute to increased losses and defaults. The growth rate of corporate debt has surpassed the growth rate of the economy in each year since 1994. A widening financing gap and increasing debt levels could pose problems if there are adverse changes in the interest rate environment or if corporate revenue growth slows. Rising rates will increase the costs of servicing debt, while a slowdown in revenue growth would reduce the cash flow available to service outstanding debt. Under such a scenario, business bankruptcies and failures are likely to rise, causing increased loan losses and bond defaults.

Lending to some industries involves high-risk exposures. Despite the strength of the U.S. economy, some domestic industries are continuing to experience stress. Exposures to weakened industry sectors, such as health care and oil and gas, could negatively affect C&I credit quality at insured institutions. One way to evaluate the relative riskiness of firms operating in a given industry is through **KMV Corporation's**® Expected Default Frequency™ (EDF™) analysis. KMV Corporation® has developed a proprietary method of measuring the degree of credit risk inherent in corporate borrowers by calculating an EDF™ score to estimate the probability that a firm will default on its obligations within one year.²⁵ Chart 7 diagrams syndicated loan exposures along with December 1999 EDF™ scores and the direction of change since December 1998. This chart illustrates one measure of the risk associated with the 10 industry sectors having the highest expected default

²⁴ "Global Financial System Stress: The Weak, the Vulnerable, and Those Limping Toward Recovery." Standard & Poor's. December 17, 1999.

²⁵ KMV's® proprietary calculation for EDF™ is based on (1) the current market value of the firm, (2) the structure of the firm's current obligations, and (3) the vulnerability of the firm to large changes in market value. Multiplying industry originations by median industry EDF™ scores provides an estimate of expected default volumes. This figure provides a more meaningful measure of aggregate lending risk exposure than pure origination volumes alone and can be used to rank industry exposures.

²² Houlihan Lokey's *Mergerstat*. www.mergerstat.com.

²³ "The Biggest Secret of Wall Street." May 14, 1999.

volume based on the volume of 1999 syndicated loan originations. In 1999, loans originated to mortgage lenders (including subprime lenders), communications firms, oil and gas firms, health care firms, and retail trade organizations generated the five highest expected default volumes among 50 broad industry sector classifications.

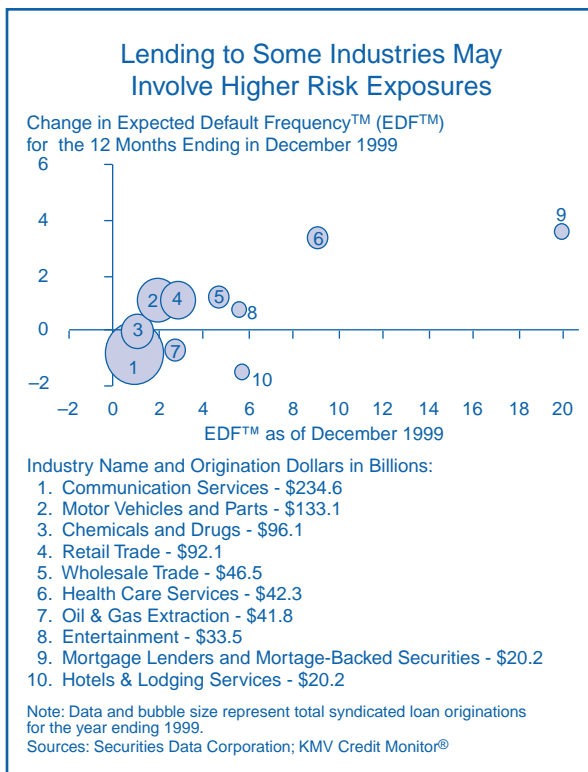
The interest rate environment and refunding risk affect the demand for and availability of credit. Declining interest yield spreads from 1996 to 1998 benefited borrowers. As spreads declined, the rate of syndicated loan growth increased and refinancing activity was high. Increases in spreads since 1998, along with higher interest rates, have caused refinancing activity to slow significantly. However, rising rates have not significantly affected origination volumes, as new debt continues to come into the market. Rising interest rates and refunding risk particularly affect speculative-grade borrowers. Higher interest rates would raise businesses' cost of borrowing, potentially decreasing the demand for business credit and impairing borrowers' ability to repay their debts. Once a corporation's debt service ability is compromised, access to new capital markets can become limited. A sharp rise in interest rates would particularly impair the ability of highly leveraged firms to repay floating-rate debt obligations.

Refunding risk continues to be a concern for speculative-grade borrowers as they face potential problems refinancing the maturing portions of long-term debt. The current tightening of terms in the C&I market and increasing default rates heighten refunding risk to borrowers. Rising interest rates or limited access to secondary markets could also increase refunding risk. This situation could continue to be problematic, since a rising volume of speculative-grade borrowings, consisting largely of unsecured bank debt, matures in 2001 and 2002. Specifically, \$64 billion in speculative-grade debt matures in 2001 and 2002, and approximately 63 percent of the debt is unsecured.²⁶

Potential growth in new markets presents both opportunities and challenges. The Internet and European syndicated loan markets represent both future potential growth areas and possible sources of credit risk for C&I lenders. The Internet has introduced large new markets to the loan and bond markets and has

²⁶ "Refunding Risk for Speculative Grade Borrowers." December 15, 1999.

CHART 7



increased market efficiency. The "Internet economy" grew 68 percent from the first quarter of 1998 to the first quarter of 1999, with annual revenue expected to exceed \$500 billion in 1999.²⁷ Internet technology has improved the efficiency of the syndicated loan markets, with recent changes including the development of public price reporting, credit ratings, and Internet sites for online trading.²⁸ Increased levels of credit risk could result from the volatility of Internet stock prices and the competitive disadvantage faced by firms that do not have an Internet presence but must compete against firms that do.

While the majority of syndicated loan financing currently occurs in the United States, analysts predict that syndicated lending activity in Europe will accelerate significantly because of increased cross-border competition generated by the introduction of the euro and new financing needs. In addition, the European high-yield bond market is still developing but produced \$6.8 billion of volume in the third quarter of 1999, or 61 per-

²⁷ "Internet Indicators." The Center for Research in Electronic Commerce at the University of Texas Graduate School of Business, October 27, 1999.

²⁸ "Syndicated Loan Market Soars as Efficiency Increases." *The Wall Street Journal*, December 6, 1999.

cent of the total market.²⁹ Domestic lenders have begun to compete for this market but face credit risks because the European markets also pose sovereign and foreign exchange risk.

Underwriting Remains the Key to Assessing C&I Credit Quality

The August 1999 *OCC Survey of Credit Underwriting Practices* reported some tightening of commercial loan underwriting standards. However, loan officers also reported increased embedded risks in commercial loan portfolios for the fifth consecutive year. Survey respondents attributed the increased risks to weakened underwriting standards in previous years. The November 1999 *Federal Reserve Board Senior Loan Officer Opinion Survey on Bank Lending Practices* found that 30 percent of domestic banks reported increasing risk premiums, credit line costs, and loan spreads during the preceding three months. Loan officers cited an uncertain or unfavorable economic outlook, an expected worsening of industry-specific problems, and a reduced tolerance for risk as reasons for tightening C&I lending standards.



Despite signs of tightening underwriting standards, the mix of credits appears to be riskier than in recent times. The OCC issued an advisory to banks in May 1999 warning of potential problems with leveraged lending. The OCC stated that highly leveraged corporations could be particularly vulnerable to economic weakness and may not be able to compete effectively in a rising

interest rate environment. The OCC also addressed reliance on enterprise value loans, which are often used to support leveraged lending. Enterprise values are calculations based on projections of the future income of a firm. If such estimates are overly optimistic, or if the company fails to meet the assumptions underlying these estimates, the lender may be subject to considerable credit risk. The last interagency SNC review also noted instances of inadequate documentation and support for enterprise loans.³⁰

Summary

C&I lending is one of the largest and fastest growing lending lines at insured institutions. Recent growth in C&I lending can be attributed to a number of factors, including a favorable economy, merger and acquisition activity, and other sources of high loan demand, strong asset quality, aggressive pricing, and attractive fee income. While indicators of C&I loan performance remain generally strong, signs of deterioration in commercial credit quality have begun to surface. These signs are cause for some concern because they are surfacing during a period of remarkable economic strength. Increasing corporate indebtedness, signs of corporate stress, and adverse trends in corporate bond defaults suggest that an economic downturn could result in a much more challenging environment for business credit quality.

*By Arlinda Sothoron, Senior Financial Analyst
Alan Deaton, Economic Analyst*

²⁹ *LPC Gold Sheets*, Vol. XII, No. 44. Loan Pricing Corporation. November 15, 1999.

³⁰ Remarks by OCC First Senior Deputy Comptroller and Chief Counsel Julie L. Williams before the Robert Morris Associates Conference on Lending and Credit Risk Management, October 5, 1999.

Local Industries in the Global Economy

- **The contribution of international trade to U.S. economic activity has risen rapidly during the past decade. The U.S. economy has been increasingly influenced by conditions abroad, such as the recent financial market turmoil in several emerging markets.**
- **Canada, Japan, and Mexico are the largest U.S. trading partners, accounting for approximately 40 percent of U.S. trade. Western Europe and Asia (excluding Japan) also account for a large share of U.S. trade.**
- **The importance of trade at the industry level varies widely. The industries most dependent on trade, including machinery and transportation equipment, also account for a large share of U.S. trade.**

The value of goods and services traded on international markets has more than doubled during the past decade. More goods and services than ever are being shipped abroad and imported from all parts of the globe. Consequently, U.S. economic activity is increasingly influenced by the flow of goods, services, and capital across national borders.

The increasing importance of international trade is reflected in different types and levels of exposure to international markets. First, total exports and imports compared with overall economic activity confirm the increasing contribution of trade to the economy as a whole. Second, the amount of U.S. trade with foreign markets, although widely varied, is concentrated in a small number of countries, namely Canada, Japan, and Mexico. Consequently, economic conditions in these countries are particularly important in assessing the influence of global economic conditions on U.S. trade. Third, the level of exposure to international trade across industry sectors varies considerably. Some industries are not influenced greatly by activity in international markets, while for other, more trade-dependent industries, conditions in the world economy are an important factor in determining the level of sales and profit. The exposure to international markets, either through reliance on trade with particular countries or via industries with a significant exposure to international markets, is an important consideration for lenders seeking to determine a firm's future profitability and financial condition.

International Trade Is of Growing Importance

Over the past 30 years, international trade has grown more quickly than the economy as a whole. Exports, which include both merchandise and services, have risen from less than 5 percent of U.S. gross domestic product (GDP) in 1970 to approximately 12 percent today. The merchandise component accounts for about 73 percent of exports and includes manufactured goods, agricultural products, and raw materials such as metals and oil. The services component of exports, accounting for about 28 percent of total exports, includes travel services, passenger fares, royalties, freight and port services, and a number of smaller sectors such as financial and educational services.

Imports also account for a growing share of U.S. consumption of goods and services, exceeding 15 percent of U.S. GDP in 1999, up from 6 percent in 1970. Merchandise is the largest component of imports, accounting for 83 percent, while services account for 17 percent (see Table 1, next page).

Although trade in services has grown quickly for many years, merchandise still accounts for the majority of all trade. The dominance of merchandise is attributable, in part, to the difficulty of trading many types of services. With few exceptions, services are generally produced and consumed within a local market because they cannot be transported easily and are subject to language and cultural barriers. Hospitals, dry cleaners, and movie theaters, for example, serve well-defined local markets and produce products that cannot be traded competitively on international markets. Although trade in services such as travel continues to grow, the remainder of this article focuses primarily on the dominant merchandise component.

U.S. Trade Activity Has Reflected Recent Global Economic Turmoil

Over time, conditions in the international economy have become an increasingly important influence on U.S. growth, since a rising share of all domestically produced goods and services is sold abroad. Similarly, an increasing volume of imported goods and services implies a higher level of competition for domestic producers that compete directly with imports.

TABLE 1

MERCHANDISE IS THE LARGEST COMPONENT OF TRADE			
	DOLLAR VALUE* (1998, \$ MILLIONS)	PERCENT OF TOTAL	1999 GROWTH**
EXPORTS	\$ 933,910	100.0%	1.8%
MERCHANDISE	682,138	73.0%	0.8%
AGRICULTURE AND RELATED COMMODITIES	26,603	2.8%	-1.8%
MINERAL COMMODITIES	6,644	0.7%	-17.4%
MANUFACTURED GOODS	593,297	63.5%	-0.1%
OTHER MERCHANDISE	55,593	6.0%	39.5%
SERVICES	263,662	28.2%	4.3%
TRAVEL	71,250	7.6%	3.0%
PASSENGER FARES	19,996	2.1%	2.7%
ROYALTIES AND LICENSE FEES	36,807	3.9%	4.1%
FREIGHT AND PORT SERVICES	25,520	2.7%	6.4%
OTHER SERVICES	110,089	11.8%	5.0%
ADJUSTMENTS***	(11,890)		
IMPORTS	\$ 1,098,193	100.0%	10.3%
MERCHANDISE	907,647	82.6%	10.4%
AGRICULTURE AND RELATED COMMODITIES	22,859	2.1%	-2.2%
MINERAL COMMODITIES	38,619	3.5%	5.6%
MANUFACTURED GOODS	803,384	73.2%	11.6%
OTHER MERCHANDISE	42,786	3.9%	-0.6%
SERVICES	181,015	16.5%	9.6%
TRAVEL	56,105	5.1%	7.2%
PASSENGER FARES	19,797	1.8%	8.3%
ROYALTIES AND LICENSE FEES	11,293	1.0%	11.0%
FREIGHT AND PORT SERVICES	30,460	2.8%	11.4%
OTHER SERVICES	63,360	5.8%	10.9%
ADJUSTMENTS***	9,531		
<p>* SUM OF COMPONENTS MAY NOT EQUAL TOTAL DUE TO ROUNDING.</p> <p>** FIRST THREE QUARTERS OF 1999 VERSUS FIRST THREE QUARTERS OF 1998.</p> <p>*** BECAUSE OF DIFFERENT METHODS OF ESTIMATING THE MERCHANDISE AND SERVICES COMPONENTS OF TRADE, AN ADJUSTMENT TERM IS NECESSARY. CONSEQUENTLY, PERCENTAGES MAY NOT SUM TO 100.</p> <p>SOURCES: BUREAU OF ECONOMIC ANALYSIS; BUREAU OF CENSUS</p>			

During the past two and a half years, for example, the international economy has been buffeted by a series of crises that resulted in steep exchange rate depreciations for a number of countries and a marked slowdown in economic growth in many emerging markets. Although the U.S. economy remained surprisingly strong during the worst of the emerging markets crises, the fallout was evident in the diverging performance of U.S. exports and imports over the period.

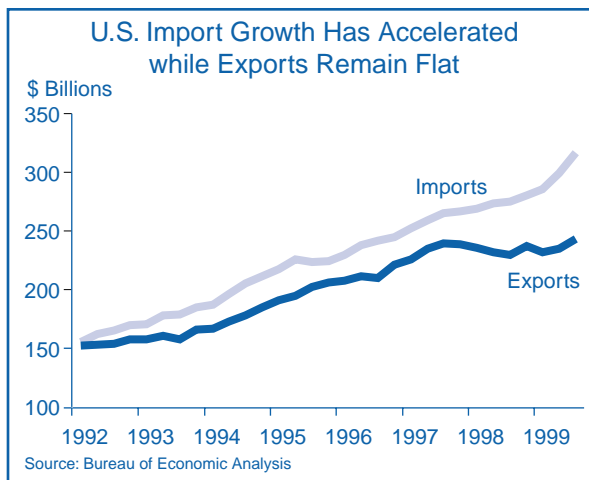
From mid-1997 through mid-1999, U.S. exports were generally flat, reflecting the sluggish pace of growth in several important U.S. export markets. Export prices fell by 4 percent over the period in response to weak demand for U.S. exports. In particular, exporters of agricultural products, basic manufactured goods, and commodities faced rapidly deteriorating conditions in several important overseas markets. For example, the value of merchandise exports to the Pacific Rim fell by 15 percent during the first six months of 1999 compared with the same period in 1997 because of the recent financial market turmoil in the region.

U.S. imports continued to grow during the period, however, reflecting both strong demand for imported goods and falling prices. In fact, average import prices fell by 5 percent between 1997 and 1999. At the same time, competition from imports limited the pricing power of domestic producers that compete with goods produced abroad. Although producers that compete with cheaper imports experienced adverse effects on profitability, consumers and firms that purchased goods from abroad generally benefited from falling import prices.¹

The slowdown in U.S. export activity and the acceleration of import growth have resulted in an increasing trade imbalance (see Chart 1). The U.S. trade deficit, which reached a record \$26.5 billion in November, has raised concerns among analysts about the vulnerability of the dollar. Faster growth abroad or a slowdown in U.S. growth could convince foreign investors to increase purchases of assets outside the United States, resulting in a sell-off of the dollar. Depending on the severity and speed of a sell-off, heightened financial market volatility and rising U.S. import prices could result. Although potentially many forces are at work in

¹ Weak import prices are a factor cited by analysts to explain the benign performance of U.S. inflation during the past few years.

CHART 1



such a scenario, rising inflation or a falling dollar may ultimately result in higher interest rates and slower U.S. growth. The extent to which U.S. trade would be affected by such a scenario is difficult to assess, since changes in the prices of either imports or exports would result in both positive and negative effects on firms' costs, revenue, and profitability.²

Most U.S. Trade Is Concentrated in a Few Foreign Markets

Because the United States trades with most nations, economic conditions abroad are one of the critical factors that determine the growth of U.S. trade. Foreign demand for U.S. goods and services depends on the strength of the markets to which exporters ship their goods. Consequently, economic weakness abroad often results in slower U.S. export growth. Economic conditions abroad also influence the level of import competition that U.S. firms experience. Foreign firms facing slack demand in their own domestic markets, much like manufacturers in Southeast Asia during the recent market turmoil, may

² During the early 1980s, the dollar rose by roughly 50 percent, as measured against a trade-weighted basket of currencies. The increase in the value of the dollar made U.S. exports much more costly on world markets and contributed to financial stress among export-dependent manufacturers and agriculture producers. Beginning in mid-1985 the dollar fell sharply, back to its pre-appreciation level. The resulting improvement in U.S. competitiveness contributed to robust growth in U.S. exports that lasted during the rest of the 1980s.

reduce prices of their U.S.-bound goods to compete more effectively with U.S. producers.³

Although the U.S. trades with many nations, a large share of U.S. trade is concentrated among a small number of countries. Canada, Mexico, and Japan account for more than 40 percent of merchandise exports and imports. Asia (excluding Japan) and Western Europe each account for just over 20 percent of U.S. exports and a broadly similar share of imports. Central and South America, despite proximity to the United States, account for less than 10 percent of exports and only 5 percent of imports (see Chart 2).

The United States has routinely run a trade deficit with its largest trading partners. The trade deficit with Canada was \$22.8 billion through the first three quarters of 1999. The trade deficit with Mexico topped \$18.8 billion during the same period. The trade deficits with Japan and China, by far the two largest at \$53.4 billion and \$49.4 billion, respectively, accounted for approximately 40 percent of the total U.S. merchandise trade deficit through the first three quarters of 1999.

The Importance of Trade Varies among Industries

The level of export activity or the intensity of import competition also varies across industries. Besides the overall dollar volume of exports, industries differ in the proportion of total production that is exported. Although some industries, such as leather products, account for a relatively small share of total U.S. exports, exports from this industry make up a large share of all U.S. leather goods production. In cases such as this, conditions in export markets are important for producers even if total export sales from a particular industry are small.

Industries also differ in the share of total spending devoted to imports. Imports account for a relatively

³ From the perspective of a foreign exporter, increased sales of goods abroad, even at reduced prices, may be a preferred strategy to offset lower sales within its own weaker domestic market. A foreign steel mill facing weak sales in its home market may choose to sell its output below cost on the world market if it can still cover its fixed costs of operation. There also may be an incentive to maintain or even expand market share and recoup current losses in the future when prices rebound.

CHART 2



small portion of all domestic spending on farm products such as grains and livestock, for example, while imports account for a relatively large share of all U.S. oil consumption. These differences expose U.S. industries to varying levels of competition from abroad. In industries characterized by high levels of import competition, import prices may largely shape the domestic pricing environment and, by extension, the revenue and profit growth of domestic firms.

For the purposes of this article, industries can be assigned to one of three broad categories depending on their exposure to international markets either through exports or through the intensity of import competition. Firms in *Less Exposed Industries* are not directly influenced by conditions in the global markets. Export markets are not a particularly important source of revenue, and imports are a negligible share of all domestic consumption of goods produced by these industries. In contrast, some industries are highly exposed through their reliance on export markets, through competition from imports, or in some cases, through both. For firms in these *Highly Exposed Industries*, conditions in international markets are clearly one of the important factors influencing current and prospective financial performance. Industries not part of either group, or *Moderately Exposed Industries*, face some competition from abroad and may earn a relatively small amount of revenue from export markets.

To gauge these differences more fully, a measure of exposure to international markets was calculated for a set of 26 industries (20 manufacturing industries, 4 mining industries, and 2 agriculture sectors). Table 2

TABLE 2

INDUSTRY EXPOSURE TO INTERNATIONAL TRADE				
		IMPORT SHARE OF U.S. CONSUMPTION		
		Low	MEDIUM	High
EXPORT SHARE OF U.S. PRODUCTION	Low	PRINTING AND PUBLISHING FOOD PRODUCTS	LUMBER AND WOOD PRODUCTS PETROLEUM AND COAL PRODUCTS AGRICULTURAL SERVICES, FORESTRY, AND FISHING FURNITURE AND FIXTURES	OIL AND GAS EXTRACTION
	MEDIUM	COAL MINING TOBACCO PRODUCTS NONMETALLIC MINERALS, EXCEPT FUELS FABRICATED METAL PRODUCTS	METAL MINING PAPER AND ALLIED PRODUCTS TEXTILE MILL PRODUCTS STONE, CLAY, AND GLASS PRODUCTS RUBBER AND PLASTIC PRODUCTS PRIMARY METAL INDUSTRIES	MISCELLANEOUS MANU- FACTURING INDUSTRIES APPAREL PRODUCTS
	High	FARM PRODUCTS	CHEMICALS AND ALLIED PRODUCTS INSTRUMENTS AND RELATED PRODUCTS	TRANSPORTATION EQUIPMENT INDUSTRIAL MACHINERY AND EQUIPMENT ELECTRONIC EQUIPMENT LEATHER AND LEATHER PRODUCTS
<div> <div></div> HIGHLY EXPOSED INDUSTRIES <div></div> MODERATELY EXPOSED INDUSTRIES <div></div> LESS EXPOSED INDUSTRIES </div>				

summarizes the results of the assessment.⁴ Each row shows industries that have high, medium, or low reliance on export markets, defined as the share of U.S. production in a particular industry that is exported. Each industry was ranked by this measure, with the 7 highest industries placed in the High category, the 7 lowest in the Low category, and the remaining 12 in the

Medium category.⁵ Table 2 shows, for example, that a relatively low proportion of production in the printing and publishing, lumber and wood products, and oil and gas extraction industries is exported. In contrast, a relatively high percentage of production in the farm products sector, chemicals, and transportation equipment industries is exported.

⁴ Export share of production (rows in Table 2) was calculated as the ratio of inflation-adjusted exports at the industry level divided by inflation-adjusted production in that industry (Gross Output by Industry from the Bureau of Economic Analysis was used as a measure of industry production). The import share of consumption (columns in Table 2) was calculated as the share of inflation-adjusted industry imports divided by inflation-adjusted domestic production less exports plus imports. All calculations were based on 1997 data, the latest industry-level production data available.

⁵ This allocation, while completely arbitrary, roughly corresponds to a distribution where 50 percent of the industries are assigned to the Medium category, with the remaining 50 percent evenly allocated between the High and Low categories. Breakpoints for the distribution of industries by export share of production were as follows: Low: less than 7 percent; High: greater than 13 percent.

The industries in each column are categorized by the share of U.S. consumption expenditures in a particular industry that are satisfied by imports. Again, the Low and High categories each include 7 industries, and the Medium category includes the remaining 12 industries.⁶ On the basis of this analysis, for example, a relatively low share of U.S. consumption of food, fabricated metals, and farm products is imported. In contrast, a large share of U.S. consumption of oil, apparel, and electronic equipment is imported.⁷

As shown in the lower right cell of the table, four industries are highly exposed to both export markets and import competition. These industries—transportation equipment, industrial machinery, electronic equipment, and leather products—account for slightly less than half of total U.S. exports and a similar percentage of total U.S. imports. Not only are these industries more closely tied to international markets than most other industries examined, but they also account for a large share of U.S. international trade.

Using the terminology introduced above, Highly Exposed Industries are defined as those assigned to either of the High categories; industries in this group either are very reliant on export markets or face high levels of import competition. Less Exposed Industries are defined as those that have little exposure to either export markets or import competition; they are shown in the upper left cell in the Low classification. The remaining industries are defined as Moderately Exposed Industries.

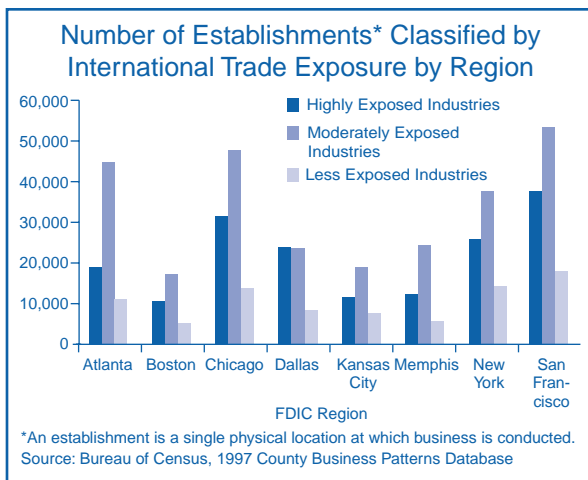
Chart 3 illustrates the distribution of establishments in each of the three categories by Region.⁸ Among the

⁶ Breakpoints for the distribution of industries by import share of consumption were as follows: Low: less than 9 percent; High: greater than 25 percent.

⁷ Although not directly included in the analysis, most domestically produced services also have minimal reliance on export markets and face little import competition. Retail trade, construction, local transportation services, and government, for example, all operate in relatively sheltered markets and are dependent on the health of the local economy. Particular firms may engage in high levels of international activity in tradable services such as travel, but manufacturing, mining, and agriculture account for the majority of imports and exports.

⁸ An establishment is defined as a single physical location at which business is conducted or services or industrial operations are performed. It is not necessarily identical with a company or enterprise, which may consist of one or more establishments. Data are from *County Business Patterns* (Bureau of Census, 1997).

CHART 3



group of industries analyzed, most are in the Moderately Exposed Industries category. Of the FDIC Regions, Atlanta, Chicago, and San Francisco have the greatest number of establishments in this category. The Chicago and San Francisco Regions lead in the number of establishments in the Highly Exposed Industries group, followed by the New York and Dallas Regions.⁹ Less Exposed Industries account for a relatively small number of establishments. As suggested above, however, most service-sector, construction, and government enterprises, while not part of this analysis, could be classified as Less Exposed.¹⁰

Although this analysis highlights the varying level of direct exposure to international markets, industries also may be exposed through a less direct secondary channel. Several industries, although not highly exposed themselves, are suppliers to Highly Exposed Industries. For example, the rubber and plastics industry produces goods that are used in the manufacture and assembly of transportation equipment, a Highly Exposed Industry.

⁹ An alternative way of analyzing the establishment data is to calculate the percentage of all establishments across the 25 industries that are in Highly Exposed Industries. On the basis of this calculation, the Dallas Region ranks highest at 42 percent because of the large number of establishments engaged in oil and gas extraction. For the remaining Regions, the percentages vary between 25 percent and 35 percent. Across all industries (including services and other sectors not part of this analysis), the percentage of Highly Exposed Industries in each Region ranges from 1.7 percent (Atlanta Region) to 3.4 percent (Boston Region) of total establishments.

¹⁰ These data do not include a count of establishments in the farm products sector (Standard Industrial Code (SIC) 01 and SIC 02). Therefore, 25 industries are represented in the establishment data, and not 26 as in Table 2.

Consequently, conditions in export markets for transportation equipment are of particular interest for manufacturers of certain types of rubber and plastic products. These supplier industries are also vulnerable to import competition through this secondary exposure to international markets. A transportation equipment manufacturer, in response to heightened competition in international markets for its products, may switch from a domestic supplier of rubber products to a cheaper foreign supplier if a favorable price differential emerges. Therefore, assessing the exposure of industries to either exports or imports requires consideration of any secondary linkages between suppliers and purchasers of industry products.

Summary

The contribution of international trade to overall U.S. economic activity has been increasing for a number of years. The growing significance of trade has been high-

lighted by the recent series of economic and financial crises across the globe. One result of recent global economic turmoil has been a slowdown in U.S. export growth resulting from both slumping international demand for U.S. goods and services and weak prices. Import growth has continued unabated, largely because of strong U.S. growth, leading to a rapidly widening trade deficit. The effects of import and export growth on particular industries vary because of differing levels of reliance on export markets and the extent of import competition. This analysis suggests that several industries are highly exposed to changing global economic conditions. Lenders should be aware that for firms in these industries, changes in global economic conditions, including demand for U.S. exports and prices of both imports and exports, largely determine pricing, revenue growth, and profitability.

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Regional Perspectives

- The Boston Region's economy continued to expand during 1999 but showed signs of slowing.
- Rising housing costs in greater Boston may make it more difficult for companies to attract new workers into the area's already tight labor market.
- Insured institutions reported healthy financial conditions during 1999, with stable profitability levels despite falling margins for most institutions over the past two years.
- Overall, the risk profile of the Region's insured institutions shows no material adverse trends.

Region's Economic and Banking Conditions

Economy Continued to Expand in 1999 but Rate of Growth Eased

The Boston Region closed the decade with another good year in its roughly seven-year-long economic expansion. However, the Region's economy showed signs of slowing. Although job growth remained positive, net job losses in the manufacturing sector and slower net gains (relative to 1998) in most other sectors combined for a reduced rate of nonfarm job growth during 1999.¹ Construction continued to show the strongest percentage gain in employment, while trade and services (including financial) added the most net new jobs. Per capita income growth likely exceeded the national average for the sixth consecutive year during 1999, based on a 4.9 percent year-over-year gain experienced during the first six months (versus 4.5 percent for the nation). Still, income growth has been gradually decelerating in the Region since peaking in 1995. Home sales growth eased during 1999 and permit issuance for new homes dropped modestly. Both of these economic indicators made strong advances in 1998, and some slowdown was inevitable. With financial markets anticipating further interest rate increases, economic activity in the Region could decelerate further in 2000.

¹ This assessment was based on data available during January 2000. Annual benchmark revisions that occur in March 2000 may alter these results substantially.

Surging Home Prices May Lower the Boston Area's Cost-Competitiveness

As mentioned above, home sales and building permit issuance eased last year, following gains in 1998 that were among the strongest of the current expansion. Nevertheless, home price appreciation accelerated again in 1999 to its fastest pace since the 12 to 22 percent annual gains experienced between 1983 and 1987. The *Fannie Mae/Freddie Mac* quality-constant home price index showed a gain of 8 percent (annual rate) through third-quarter 1999. All of the Region's states experienced some of their highest levels of price appreciation in a decade during the past two years. **Massachusetts** posted the most rapid advance among the states in 1999 at 10 percent. Other data and anecdotal reports suggest that this gain is being driven by the eastern portion of the state, primarily the greater **Boston** area. For example, median home resale prices reported by the *National Association of Realtors* (non-quality-adjusted) showed an annual gain of nearly 12 percent during the first three quarters of 1999 for the Boston metropolitan area. Meanwhile, other metropolitan areas were less robust. For example, **Springfield** posted a modest decline in median resale prices from 1998.

As home prices appreciate strongly in greater Boston, it may become more difficult for companies to attract new workers from other parts of the Region and nation that have more affordable housing prices. Boston's high home costs are pronounced compared with other large cities in the nation and even in other areas of Massa-

chusetts. Median prices in Boston, as of third-quarter 1999, were almost 88 percent above the national average. While prices were below the peak experienced during third-quarter 1987 (when prices in the metro area were slightly more than double those of the nation), this gap was the widest in nine years.

While the price gap in Boston has been steadily expanding, Springfield and **Worcester**, the state's other major metropolitan areas, have lagged. Springfield resale prices were 13 percent *below* the national median during third-quarter 1999. This figure is modestly above the low point for this expansion (a 16 percent deficit in late 1997) but well behind 1989, when prices in Springfield were almost 44 percent *above* the national median. No 1999 data were available for Worcester when this article was written, but during 1998 median resale prices were about 8 percent higher than the national average. Still, the 1998 Worcester price gap was the slimmest reported since data collection began in 1987.

To some extent, home prices in Boston are elevated by a generally higher income level. Median resale prices have been influenced by a preponderance of sales of costly homes, which are being purchased by the area's well-compensated financial and technology workers.

However, high housing prices remain an issue when firms try to recruit middle managers and other, less highly compensated employees from other areas. Higher home prices may further limit the number of available workers in the greater Boston area, where a low unemployment rate is already thought to be restraining job growth. Rising mortgage rates and rapidly increasing rental rates may further constrain housing affordability during 2000. To the extent that businesses are forced to relocate or expand elsewhere, smaller insured institutions operating in the Boston area could see more intense competition for new and existing business. This competition could negatively affect pricing and underwriting standards.

Insured Institutions Continue to Perform Well

Insured institutions in the Boston Region reported healthy financial conditions during the first nine months of 1999 (see Table 1). Despite falling margins for most institutions over the past two years, profitability levels remained fairly stable largely because of rising levels of noninterest income, slightly lower loan loss provisions, and lower effective tax rates. The Region's insured institutions continue to experience funding

TABLE 1

FINANCIAL PERFORMANCE REMAINS SOLID DESPITE FALLING MARGINS												
	BOSTON REGION*			LESS THAN \$1 BILLION*			GREATER THAN \$1 BILLION LESS THAN \$25 BILLION*			GREATER THAN \$25 BILLION*		
	SEP 99	SEP 98	SEP 97	SEP 99	SEP 98	SEP 97	SEP 99	SEP 98	SEP 97	SEP 99	SEP 98	SEP 97
RETURN ON ASSETS (ROA) (YTD)	1.20	1.20	1.24	1.06	1.10	1.09	1.15	1.24	1.10	1.29	1.22	1.37
NET INTEREST MARGIN (NIM) (YTD)	3.78	3.81	4.03	3.86	3.94	4.06	3.71	3.77	3.91	3.78	3.80	4.08
PAST-DUE RATIO	1.37	1.54	1.96	1.49	1.88	2.31	1.21	1.57	1.91	1.39	1.36	1.82
CORE DEPOSITS/ASSETS	50.54	53.97	57.30	70.92	72.84	74.53	60.80	66.15	68.08	36.73	39.87	44.30
NONCORE FUNDING/ASSETS	37.22	34.47	31.33	17.79	15.50	13.97	29.81	23.77	22.63	49.21	47.80	43.31
LOANS/ASSETS	57.36	58.89	59.68	64.28	64.38	64.90	59.89	62.29	63.16	53.15	54.98	55.75
C&I LOANS/LOANS	30.08	29.14	26.16	7.38	6.74	6.54	14.36	10.91	8.87	50.61	50.30	45.83
CONSUMER LOANS/LOANS	7.59	7.50	8.86	5.02	4.77	4.79	13.25	12.30	10.72	5.76	6.54	10.13
SINGLE FAMILY RE AND MBS/ASSETS	31.44	33.27	34.41	47.65	49.28	50.49	51.37	52.87	53.55	14.61	16.81	17.76
TOTAL LOAN GROWTH (YEAR OVER YEAR)	5.52	7.68	5.55	7.89	7.73	7.52	5.23	5.68	7.84	4.11	7.87	3.67
C&I LOAN GROWTH (YEAR OVER YEAR)	8.93	19.94	12.44	18.16	10.94	10.80	38.51	29.94	10.37	4.76	19.48	12.79
CONSUMER LOAN GROWTH (YEAR OVER YEAR)	6.92	-8.88	-11.39	13.39	7.35	0.98	13.38	21.22	24.24	-8.34	-29.73	-24.34
TIER ONE LEVERAGE RATIO	7.48	7.52	7.77	10.13	10.15	10.06	7.30	7.64	7.69	6.42	6.41	6.81
YTD = YEAR TO DATE; C&I = COMMERCIAL AND INDUSTRIAL; RE = REAL ESTATE; MBS = MORTGAGE-BACKED SECURITIES.												
* ALL DATA EXCLUDE CREDIT CARD INSTITUTIONS.												
SOURCE: BANK AND THRIFT CALL REPORTS; REPORTED ON A MERGER-ADJUSTED BASIS												

shifts and a decline in the ratio of core deposits to assets. On an aggregate basis, the Region's insured institutions are outperforming the nation's in terms of profitability, net interest margin, and past-due loan levels.

The Region's loan growth is driven by an increase in commercial and industrial (C&I) loans that continues to outpace overall loan growth. As a result, C&I credits are increasing as a share of loans, rising to just over 30 percent, the highest level since the last recession. The growth has been most pronounced in institutions with less than \$25 billion in total assets. Aggregate growth rates are often driven by a few large organizations; however, the Region's median C&I loan growth of nearly 18 percent during the year ended September 30, 1999, suggests that the growth is broad-based.

On an aggregate basis, consumer loan levels also have grown significantly in the past year, particularly in the Region's small and medium-sized institutions. However, the expansion is not widespread, as the median growth rate is around 1 percent. The Region's largest institutions are scaling back consumer portfolios.

Asset quality indicators remain favorable. Past-due ratios in all except the Region's largest institutions continue downward. The largest institutions reported a slight increase in past-due loans from one year earlier, led by increases in delinquent C&I and consumer loans. The results of recent regulatory agency underwriting surveys are consistent with current favorable asset quality indicators. These surveys state that C&I underwriting standards have remained fairly stable since 1998, although instances of lax underwriting are noted.

Region's Insured Institutions Exhibit Lower Risk Profile than the Nation's

Putting C&I Loan Growth in Perspective

As indicated above and in the article "Recent Trends Raise Concerns about the Future of Business Credit Quality" (*In Focus*, this issue), commercial loan growth has been quite strong. In fact, the Boston Region's aggregate commercial loan growth has outpaced the nation's for the past three years, while the median growth rate has done so for the past five. During the past 12 months, 47 percent of the Region's insured institutions that hold commercial loans expanded those portfolios in excess of 20 percent, well ahead of the 39 percent that did so nationally. In fact, the Boston Region had a higher percentage of institutions exceeding 20 percent growth than any other FDIC Region. This strong growth was primarily driven by institutions in the Region's southern three states. This was the fifth consecutive year in which over 40 percent of the Region's commercial lenders exceeded the 20 percent threshold, and as Chart 1 indicates, this percentage is approaching levels attained in the years preceding the last recession.

While the level of commercial loan growth deserves close scrutiny in light of analyst and regulator comments regarding deteriorating underwriting standards, it is also important to recognize that at least in the Region, the current situation is vastly different from that in the mid-1980s. Chart 2 shows the percentage of institutions in the Region and the nation that grew *total* loans in excess of 20 percent. As the chart indicates, the Region's insti-

tutions are well below the national level by this measure and have been since 1989, in sharp contrast to the mid-1980s. During that period, commercial loan levels were rapidly expanding in lockstep with other sectors of the loan portfolio, including commercial real estate and construction loans, resulting in rapid overall loan growth and rapidly rising aggregate levels of credit risk.

Another important factor to consider when contrasting the Region's rapid commercial loan growth with the nation's growth is that as a group, institutions in the Region, which are predominantly savings banks, typi-

CHART 1

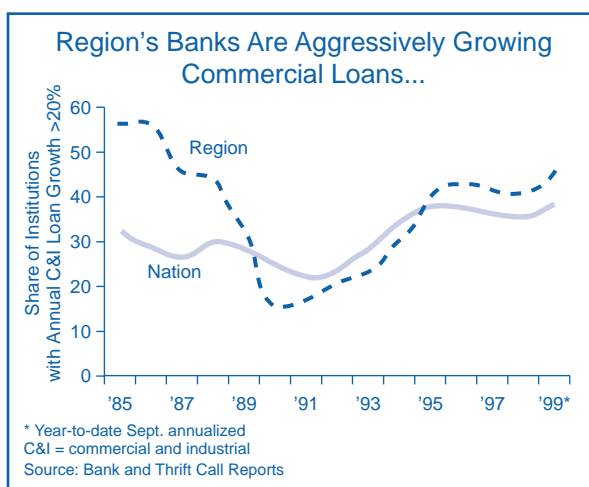
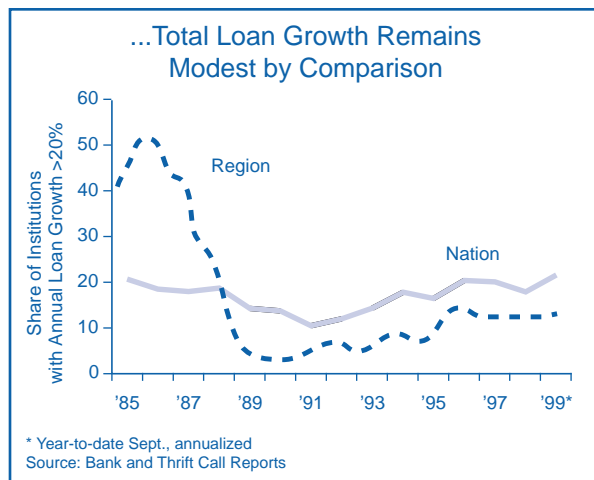


CHART 2



cally have lower concentrations of commercial loans relative to capital than institutions in other parts of the country. Of those institutions holding commercial loans, 57 percent have concentrations of less than 50 percent of Tier 1 capital. Only 23 percent of the Region's insured institutions hold commercial loans in excess of 100 percent of Tier 1 capital, compared with 43 percent nationwide. Therefore, many of the institutions that have been posting strong commercial loan growth are coming from a low base and maintain modest exposure. Several institutions in the Region, however, maintain very high concentrations in commercial loans relative to capital and continue to aggressively grow those portfolios. Aggressive growth and high exposures to individual companies, industries, or asset classes may be problematic under less robust economic conditions.

Risk Appetite for Bulk of Region's Institutions Appears to Be in Check

Among institutions headquartered in the Region, aggregate commercial loans have grown at a compounded annual rate of 12.7 percent on a merger-adjusted basis since 1994, nearly twice the 6.6 percent rate for total loans. The strong commercial loan growth has been offset by muted growth in other sectors of the portfolio, making it difficult to quantify whether aggregate credit risk is rising appreciably. In an effort to evaluate trends in, and relative levels of, aggregate credit risk for the Region's insured institutions, an analysis was undertaken to determine the relative risks posed by each individual asset class. The purpose was to develop risk weights for each asset type and develop a general measure of

credit risk embedded in each institution's loan portfolio based on its unique composition.

Risk weights were derived from observed annual loss rates for each loan type, for every insured institution in the nation, from 1984 through 1998 based on the form of Call Report filed. The risk weights attempt to capture the differing loss experience of each loan class, in terms of both average loss rates and volatility. Risk weights were applied to each loan type in a manner similar to that used in the risk-based capital computations to determine total risk-adjusted loans. This total was divided by total loans to determine a loan risk score. Historical loan risk scores were calculated for every insured institution to derive a common basis for comparison of the Region's institutions with the nation's as a whole.

It is important to note that this analysis does not attempt to quantify the specific risk in an institution. At the individual bank level, factors such as the level of nonperforming loans, underwriting standards, credit administration practices, local economic conditions, and the quality of management will either mitigate or exacerbate the risks inherent in a concentration in higher-risk assets. Moreover, this analysis is limited to credit risk and does not address other risks, such as operational risk or interest rate risk. Rather, this analysis is intended only to serve as a broad measure of credit risk and credit risk trends, based on the historical loss experience associated with each asset class on a national scale. Obviously, future trends may differ from historical experience. Furthermore, the risk-weighting process was developed by the undersigned analysts to assist in monitoring industry trends and to provide a tool for identifying emerging risks or concerns. The process is not an official measurement tool of the FDIC or any other regulatory authority. The derived risk factors and a discussion of the methodology are set forth in the accompanying appendix.

Region's Loan Portfolios Generally Show Modest Levels of Credit Risk

As of September 30, 1999, the median loan risk score for the Region was 23.6, compared with the national median of 36.3. On a stand-alone basis, the numbers are not meaningful, but when compared, they indicate that the amount of risk embedded in the loan portfolio of the Region's median bank is approximately 65 percent of that in the median bank nationwide. To put the 65 percent measure in perspective, the median institution in

the Boston Region was only at the 14th percentile risk score nationally (see Chart 3); 86 percent of the nation's insured institutions had higher risk scores than the "typical" Boston institution. Chart 3 sets forth a historical trend analysis of key percentile levels within the Region relative to where they would fall on the national scale. The chart also highlights the generally lower level of credit risk embedded in the Region's insured institutions relative to the nation as a whole.

As Chart 4 indicates, the relationship between the median loan risk scores for the nation and the Region has been fairly stable for the past several years, and more important, the median scores are significantly lower than levels maintained in the 1980s. In addition, even the Region's higher-risk institutions do not appear to be significantly altering loan risk profiles, as the 90th percentile has continued to migrate downward even as the national measure for that percentile has increased slightly.

The lower credit risk profile primarily is a result of insured institutions in the Boston Region holding large concentrations in what have historically been low-risk residential real estate loans relative to the nation as a whole. This situation is attributable to the large number of savings institutions in the Region. Nearly 70 percent of the Region's insured institutions are savings institutions, compared with only 16 percent nationally.

The relatively lower credit risk scores in the Region also derive from the fact that over 80 percent of the savings institutions are organized under a mutual form of ownership. The level of merger activity involving mutu-

CHART 3

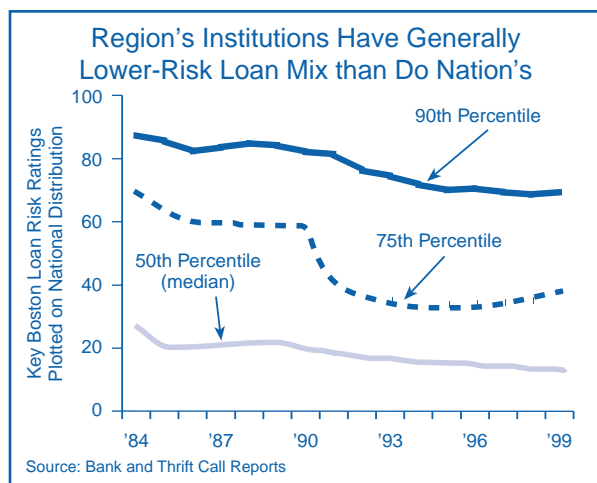
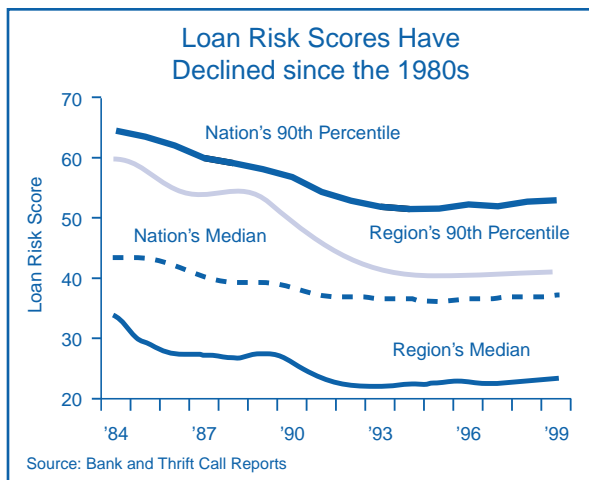


CHART 4



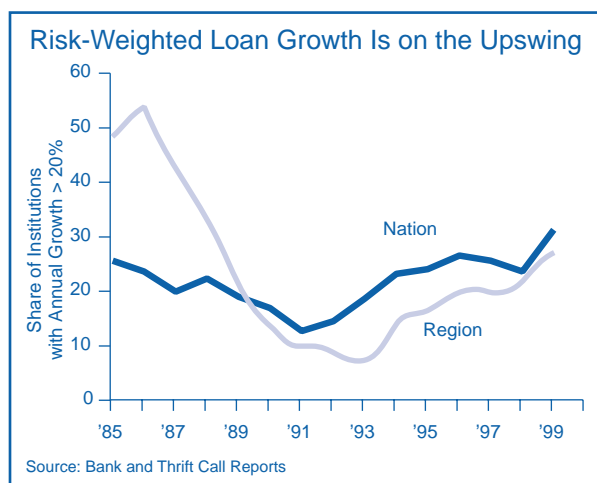
ally owned institutions is significantly lower than the level of merger activity involving stock-owned companies and contributes to a lower attrition rate for savings institutions. In fact, approximately 64 percent of the savings charters in existence as of December 31, 1987, are still operating in the Region, whereas only 35 percent of the commercial charters remain. As consolidation in the industry continues, the number of relatively higher-risk commercial banks and stock-owned savings institutions is declining as these institutions are absorbed into larger organizations. New England also has a generally lower rate of de novo activity compared with the nation as a whole. Thus, the "survivor bias" arising from the strong base of mutuals keeps the Region's median risk scores low. While this bias may distort comparison with national statistics, the bottom line is that the vast majority of the Region's institutions exhibit significantly lower loan risk profiles than insured institutions in other parts of the country. Furthermore, the relatively higher risk commercial bank portfolios are being absorbed into lower-risk converted thrifts or larger commercial banking enterprises, benefiting the acquiring institutions through increased diversification.

Generally speaking, larger institutions typically have higher loan risk profiles than smaller ones. On a national basis, the median risk score for institutions with total assets under \$500 million was approximately 15 percent lower than for institutions with total assets greater than \$5 billion. Institutions with total assets between \$500 million and \$5 billion scored approximately 10 percent lower than the larger institutions. The higher-risk profile associated with asset size is likely the result of a combination of two factors.

First, institutions in this group predominantly hold commercial banking charters, which as explained above typically have higher-risk profiles. Second, these institutions generally are publicly owned companies. An analysis of the institutions headquartered in the Boston Region revealed that the median loan risk score for subsidiaries of publicly held banks was approximately 15 percent higher than for closely held banks. Subsidiaries of publicly held savings institutions posted a median risk score that was 27 percent higher than that of mutually owned savings institutions. Clearly, the nature of ownership significantly affects an insured institution's loan mix, as the median scores for publicly held banks and thrifts were well above their closely held and mutually owned counterparts. Refer to the **Boston Regional Outlook** (Second Quarter 1999) for a detailed discussion of the differing risk profiles of the Region's insured institutions on the basis of ownership structure.

As indicated above, the percentage of insured institutions in the Region that grew commercial loans in excess of 20 percent was well above the national level, while the opposite was true for total loan growth. Chart 5 provides a similar comparison but looks at growth in risk-adjusted loans based on the previously discussed risk weights. As the chart indicates, the rapid growth rate in commercial loans is being offset by slower growth in other higher-risk sectors of the portfolio, resulting in a lower percentage of high-growth institutions in the Region than nationwide. The percentage has been rising steadily for the past few years, in sync with the prolonged economic expansion, but does not begin to approach the levels seen during the 1980s boom.

CHART 5



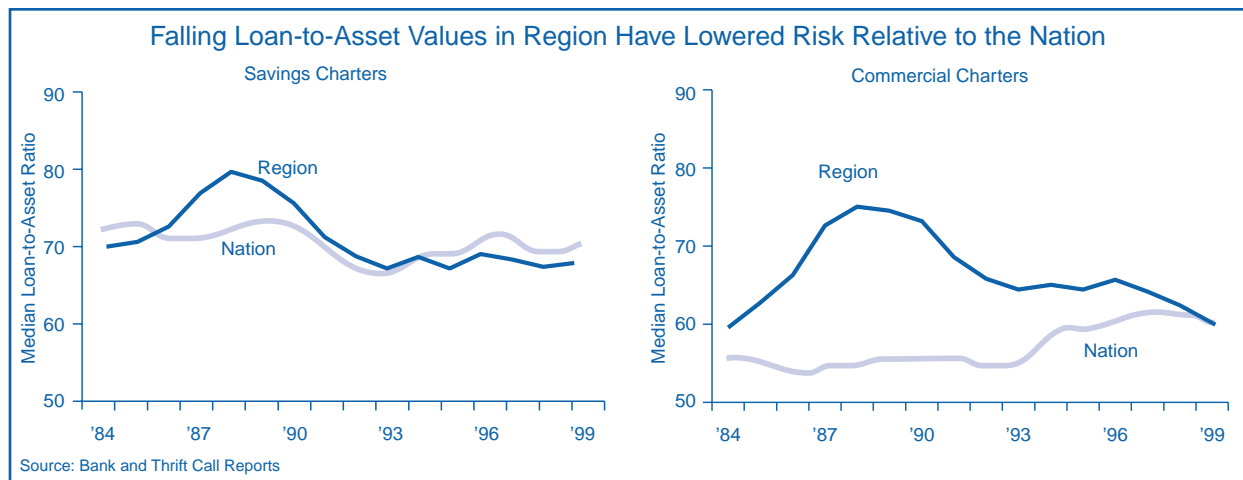
Aggregate Credit Risk within the Region Appears Stable

The risk-weighting process is useful for evaluating trends in aggregate risk in bank loan portfolios and can also help to identify those institutions that are either altering portfolio mix or growing potentially higher-risk sectors of the portfolio at a rapid rate. However, an institution's loan risk score cannot be evaluated in isolation for reasons stated previously, and also because an institution's overall asset mix must be considered when evaluating its risk profile. A relatively high loan risk score may not be a significant concern in an institution that maintains a modest level of loans to total assets and holds a large portfolio of low-risk securities. When risk weights are applied to the entire balance sheet, the median asset risk score for the Boston Region ranked at the 32nd percentile on the national scale. While on the low side, it is significantly higher than the median loan risk score (14th percentile), because Boston Region institutions tend to hold a higher percentage of assets in loans. At year-end 1988, the median loan risk score for institutions that ultimately failed in the Boston Region approximated the median for the entire country, while the median for survivor institutions fell at the 18th percentile nationally. However, when the entire balance sheet was risk weighted, the median asset risk score for failed institutions rose to the 81st percentile nationally, while the median for survivor institutions was at the 52nd percentile nationally. The higher percentile levels were attributed primarily to the high ratio of loans to assets maintained by the Region's insured institutions during that time (see Chart 6, next page).

At year-end 1988, the median loan-to-asset ratio for the Region's commercial banks was 75 percent, compared with a national median for commercial banks of only 54 percent. The savings institutions' median was 80 percent, compared with the national median for savings institutions of 73 percent. The institutions that ultimately failed in the Region maintained even higher levels of loans to assets. Clearly, the combination of widespread rapid growth of the higher-risk sectors of the loan portfolio with high concentrations of loans to assets culminated in severe problems for many institutions in this Region when the economy turned.

While we are seeing signs of strong growth in commercial loans, the Region's aggregate credit risk growth appears only moderate. Changes in the loan portfolio mix of most institutions in the Boston Region are not raising risk levels appreciably, and insured institutions

CHART 6



are maintaining a much more modest ratio of loans to assets than they did previously. Monitoring the aggregate level of risk-adjusted assets is useful in evaluating the overall risk appetite of individual institutions and the industry over time. However, the aggregate level of risk must also be measured against the amount of support a firm provides for those assets in the form of capital, reserves, earnings, and managerial expertise. The following discussion evaluates one of these sources of support: loan loss reserves.

Region's Loan Loss Reserves Remain above Nation's

An evaluation of loan loss reserve adequacy on a macro basis is difficult because the loan mix of every institution is different and carries a different level of embedded credit risk. The traditional measure of loan loss reserves to total loans provides a benchmark from which trends can be evaluated, but as loan mix shifts toward riskier loan types, this measure loses its usefulness for comparative purposes, at both the institution and industry levels. When loan loss reserves are measured against risk-weighted loans based on the weighting process discussed earlier, comparison of institutions is possible without regard to asset size, charter, or specialization.

For example, as of September 30, 1999, the national median percentage of loan loss reserves to total loans for savings institutions and commercial banks was 0.71 percent and 1.30 percent, respectively. Which is a stronger measure? If the reserve coverage of the median institutions is presumed to be adequate, then the two

ratios imply that the savings institutions' loan portfolio contains approximately 55 percent of the risk embedded in the commercial banks' portfolio. On the basis of our calculated loan risk scores, the median savings institution's score was only 48 percent of its commercial counterpart because of the higher concentrations in low-risk residential real estate loans. Loan loss reserves actually covered 3.59 percent of risk-weighted loans for the median savings institution, 20 basis points higher than the 3.39 percent coverage for the median commercial bank.

A similar relationship was noted for institutions headquartered in the Boston Region (see Table 2). As the table indicates, both types of institutions maintain stronger reserve levels relative to risk-adjusted loans than the national medians, but this has not always been the case. As Chart 7 indicates, the Region's insured institutions maintained low reserve levels relative to the risk inherent in loan portfolios in the years preceding the last recession. Reserves were aggressively bolstered as the recession deepened, with both savings and commercial institutions' coverage peaking at approximately 6 percent of risk-adjusted loans, well above national medians.

There has been much press regarding declining reserve coverage in the nation's banking system, and Chart 7 shows that as credit quality has improved, reserve coverage has declined. The drop has been most pronounced within the Region's commercial banks, most likely because of their desire to grow earnings to satisfy shareholder demands, an external pressure that is absent for most of the Region's savings institutions. Most of the decline occurred in the first three years following the

TABLE 2

SAVINGS INSTITUTIONS HAVE A HIGHER RESERVE COVERAGE OF RISK-WEIGHTED LOANS						
	NATION			REGION		
	LOAN RISK SCORE	ALLL/TOTAL LOANS (%)	ALLL/RISK- WEIGHTED LOANS (%)	LOAN RISK SCORE	ALLL/TOTAL LOANS (%)	ALLL/RISK- WEIGHTED LOANS (%)
SAVINGS INSTITUTIONS	18.24	0.71	3.59	20.44	1.00	4.64
COMMERCIAL BANKS	38.23	1.30	3.39	38.23	1.51	4.15
SAVINGS/COMMERCIAL (%)	48	55	106	53	66	112
ALLL = ALLOWANCE FOR LOAN AND LEASE LOSSES; ALLL NUMBERS REFLECT MEDIAN VALUES SOURCE: BANK AND THRIFT CALL REPORTS						

recession as low, or even negative, loan loss provisions were used to supplement weak earnings. As earnings improved in the later 1990s, however, commercial banks maintained a fairly stable level of reserves relative to risk-adjusted loans. Most important, using this risk-adjusted measure, loan loss reserves are stronger than they were in the period preceding the last economic downturn.

While the Region's insured institutions in the aggregate generally are maintaining strong reserves relative to national measures, several institutions appear to be holding portfolios that contain above-average levels of credit risk yet maintain below-average reserve levels. Chart 8 (next page) shows the relationship between loan risk scores and loss reserve coverage of risk-weighted loans for every institution in the Boston Region. A given point on the graph represents where a specific institution ranks nationally for the two variables charted. The boxed area in the lower right-hand corner represents institutions with loan risk scores in the top 25 percent of the nation but with loan reserve coverage in

the lowest quartile. Using our risk-scoring methodology, the two graphs clearly show a transition from a Region that was largely underreserved relative to the nation during 1988 to one in which the bulk of institutions maintain above-average reserve levels. Also notable is the fact that a very small percentage of the Region's institutions fell in the high-risk/low-reserve area (lower right-hand corner) as of September 30, 1999, in sharp contrast to 1988.

Summary

Commercial lending activity has been brisk in the Boston Region for several years. To help determine whether the aggregate trend is a concern, we have developed a methodology that allows us to compare institutions with different loan and asset mixes. On the basis of our analysis, the rapid growth of commercial loans in many of the Region's insured institutions does not appear to be adding an inordinate amount of incremental credit risk. Credit risk has been partially offset by

CHART 7

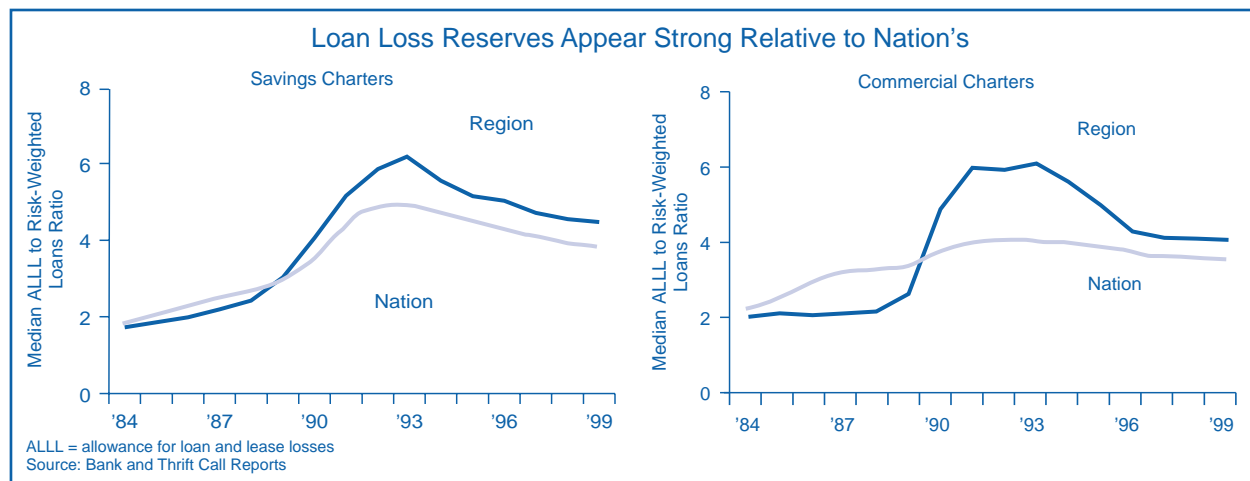
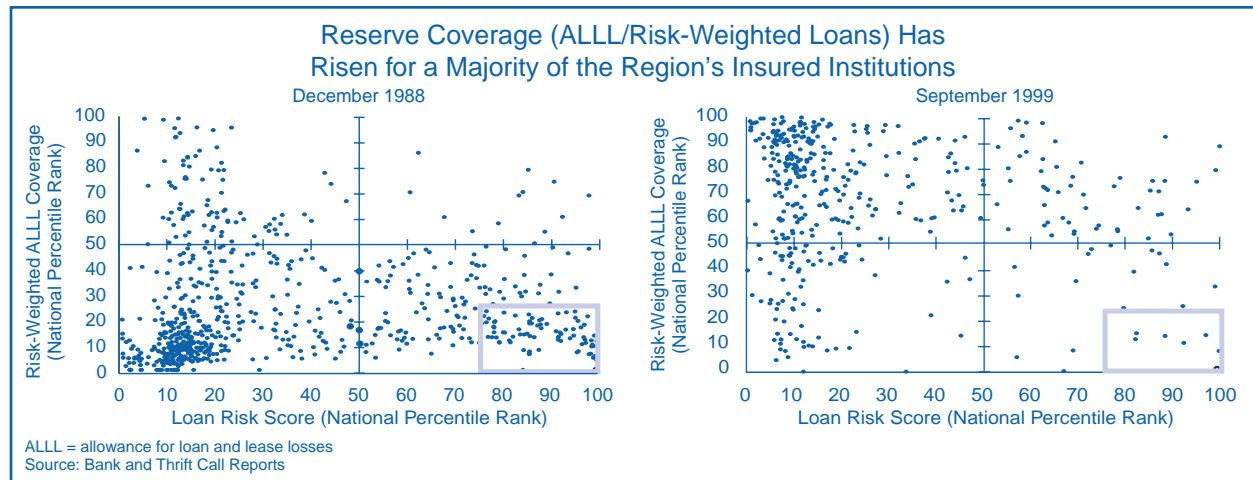


CHART 8



slow growth or even declines in other higher-risk sectors of the loan portfolio. In most instances, the increasing exposure to commercial loans remains low relative to capital, and any growth has helped to diversify portfolios away from concentrations in real estate loans. In addition, institutions are maintaining a lower weighting of loans to total assets compared with the 1980s experience. Loan loss reserves, although slowly declining for

the past few years, appear to remain very strong compared with historical periods. Overall, based on our approach to evaluating levels of credit risk, the risk profile of the Region's insured institutions appears sound, with no material adverse trends noted.

Boston Region Staff

Appendix: Risk-Weighing Methodology

The Data

Annual charge-off ratios for each loan type were collected for all of the nation's insured institutions from year-end 1984 through year-end 1998. Charge-off ratios for each type of loan were combined across time and type of institution. Our intent was to capture a measure of charge-offs to determine the relative risk associated with each loan type and derive appropriate risk weights. The top and bottom 1 percent (1st and 99th percentiles) of each sample were treated as outliers and removed to develop meaningful relative average loss rates. Institutions were segregated into six groups based on the type of Call Report filed and the size or nature of operations. We then isolated the 95th percentile value from each charge-off sample. In so doing, we captured the maximum charge-off ratio occurring in 95 percent of the observations.

Calculation of Risk Weights

Credit card charge-offs at the aggregate level (all Call Report filers that report credit card loans separately

were included) formed the base for an index of risk weights by loan class. The 95th percentile value from this category was assigned a weight of 100 (100 percent). The 95th percentile charge-off value for each loan type and for each institution type was then divided by the aggregate credit card charge-off value and multiplied by 100. Table A shows the resulting risk weights. With aggregate credit cards shown as a base of 100, all other loan types were scored *relative* to this class. In some loan types, the risk weights were adjusted because of limited sample periods that understated historical risk trends (all subcategories of total real estate loans and all loan types for Thrift Financial Report filers). Values of "N/A" indicate that information for that loan type was not reported. For those categories that resulted in a risk weight approximating zero (these are inaccurately portrayed as risk-free), the aggregate risk weight (which was generally a nominal amount) for the specific loan type was applied. Thus, the lowest loan risk weighting assigned to any loan type was 5. Values that were altered are noted with a single asterisk in Table A.

TABLE A

95TH PERCENTILE RISK SCORES—MODEL OUTPUT WITH SCALE MODIFICATIONS							
RISK SCORES (KEYED TO AGGREGATE, CREDIT CARD)							
	AGGREGATE	CREDIT CARD	31/32 FILERS ASSETS >\$1 BILLION	31/32 FILERS ASSETS <\$1 BILLION	34/33 AG FILERS	33/34 NON-AG FILERS	THRIFTS
CREDIT CARD	100	155	104	100	75	100	130
OTHER CONSUMER	39	68	36	39	38	40	36
COMMERCIAL AND INDUSTRIAL**	83	101	63	94	98	114	89
AGRICULTURE**	41	28	43	41	N/A	N/A	N/A
LEASES	28	27	40	42	O*	28	N/A
LOANS TO DEPOSITORY INST.	5	O*	21	O*	N/A	N/A	N/A
RESIDENTIAL REAL ESTATE	16	15	12	14	24	16	9
HOME EQUITY LINES	7	14	10	12	O*	1*	9
CONSTRUCTION AND DEVELOPMENT	17	45	94	56	O*	2*	54
COMMERCIAL REAL ESTATE	36	9	53	42	34	31	35
MULTIFAMILY REAL ESTATE	5	O*	48	37	O*	O*	19
TOTAL REAL ESTATE	25	19	35	32	33	23	18
OTHER	32	O*	42	26	N/A	N/A	N/A
AGGREGATE: ALL CALL FORM FILERS REPORTING DATA FOR GIVEN LOAN TYPE CREDIT CARD: 31/32 FILERS WHERE LOANS EXCEED 50 PERCENT OF MANAGED ASSETS AND CREDIT CARDS EXCEED 50 PERCENT OF TOTAL LOANS 33/34 AG/NON-AG FILERS: 33/34 FILERS WHERE AGRICULTURAL LOANS ARE AT LEAST 25 PERCENT OF TOTAL LOANS ARE AG; OTHERWISE NON-AG N/A = NOT AVAILABLE * MODEL OUTPUT WAS ADJUSTED TO AGGREGATE VALUE IN CASES WHERE LOAN RISK WEIGHTS SHOWED ESSENTIALLY RISK-FREE PROPERTIES AT THE 95TH PERCENTILE ** 33/34 CALL FORM FILERS REPORT AG AND COMMERCIAL AND INDUSTRIAL (C&I) COMBINED UNDER C&I DATA SOURCE: BANK AND THRIFT CALL REPORTS							

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